

Information Item

California Postsecondary Education Commission

Higher Education Budget Update, 2002-2003

This report summarizes the recent passage of California's State Budget for the 2002-03 fiscal year. It notes that the Governor and Legislature closed a \$24 billion gap with program cuts, loans and fund shifts, and additional revenues. The report concludes that there are continuous budget problems facing the State and that future action will be needed to bring this and next year's budgets into balance.

Presenter: Kevin G. Woolfork.



Higher Education Budget Update, 2002-03

Passage of the budget

On Saturday, August 31st, the State Legislature passed AB 425 (Oropeza), the main budget bill for the State of California for the current 2002-03 fiscal year, along with related legislation. The Governor signed the budget on Thursday, September 5, 2002, making this year the latest -- 65 days after the constitutional deadline -- that the State budget has ever been enacted. State policymakers were faced with very difficult budget decisions this year, grappling with a budget deficit that grew from estimates of \$10 billion last December to nearly \$24 billion by this past May.

After much consideration, the Legislature and Governor enacted a State budget that spends less in State General funds in the current fiscal year than in the past (2001-02) year. Actual year-to-year reductions in General Fund spending had occurred during the recession of the 1990s, but the current decline is only the third such in the last half-century. Display 1 below summarizes the actions taken by the Governor and Legislature to address the budget gap.

DISPLAY 1 Actions to Close \$23.6 Billion Gap, and as Percentages of the Total (Dollars in Millions)

	<u>Dollars</u>	<u>Percent</u>
Program Reductions	\$7,458	31.5%
Tobacco Settlement Securitization	4,500	19.0%
Loans	2,028	8.6%
Deferral of Education Disbursements (1 month)	1,728	7.3%
Fund Shifts	1,328	5.6%
Net Operating Loss (NOL) Deferral (2 year)	1,200	5.1%
Debt Restructuring	1,083	4.6%
Federal Tax Conformity/Tax Compliance	1,081	4.6%
Federal Funding Increases	1,081	4.6%
Fund Transfers	904	3.8%
Other Accelerations & Transfers	681	2.9%
Stock Options/Bonuses Withholding	400	1.7%
<u>Teacher Tax Credit One-Year Suspension</u>	<u>170</u>	<u>0.7%</u>
<i>Total</i>	\$23,642	100.0%

Source: California Department of Finance.

In signing the budget, the Governor vetoed \$235 million in General Fund and Special Fund expenditures. Total General, Special, and Bond Fund spending in the new budget is estimated at just under \$99 billion, down \$4 billion from last year. The largest single action to balance the budget is a reduction of \$7.5 billion in spending from what had been approved through the legislative budget subcommittee process. When coupled with the scaling-back that occurred in and after budget Conference Committee, and the \$2 billion in 2001-02 mid-year spending reductions approved last January, program reductions over the last twelve months amount to more than \$10 billion. The final 2002-03 budget also spends funds anticipated by California as part of the State's tobacco tax settlement, relies on loans and internal fund shifts, and depends on the deferral of some funds due to education into the next fiscal year.

Display 2 below compares funding levels for General Fund spending by program area for both the current and prior fiscal years.

DISPLAY 2 2002-03 and 2001-02 State General Fund Expenditures by Category, with Changes (Dollars in Millions)

	(Estimated) <u>2001-02</u>	(Budgeted) <u>2002-03</u>	Changes:	
			<u>Dollars</u>	<u>Percent</u>
State and Consumer Services	715	471	-244	-34.1%
Business, Transportation & Housing	645	228	-417	-64.7%
Technology, Trade, and Commerce	75	42	-33	-44.0%
Resources	1,545	1,041	-504	-32.6%
Environmental Protection	437	173	-264	-60.4%
Health and Human Services	22,093	21,633	-460	-2.1%
Youth and Adult Correctional	5,544	5,285	-259	-4.7%
K-12 Education	29,589	30,769	1,180	4.0%
Higher Education ¹	9,646	9,749	102	1.1%
<u>General Government/Tax Relief</u>	<u>3,407</u>	<u>4,857</u>	<u>1,450</u>	<u>42.6%</u>
<i>Total</i>	\$73,697	\$74,248	\$551	0.7%

1. Includes: UC, CSU, CCC, Hastings College, CSAC, CPEC, bond interest, loans, and miscellaneous funds.

Source: California Department of Finance.

The expenditure category "General Government/Tax Relief" shows the largest one-year growth, for the most part due to tax relief measures enacted over the past few years.

Education

As Display 2 shows, spending on K-12 education increased by \$1,180 million (4%) in the budget. This increase includes funds for average daily attendance growth of 1.4 percent, a 2 percent cost of living adjustment (COLA), and \$150 million in one-time monies to purchase standards-aligned instructional materials for K-12 students. The budget provides a total of \$46.5 billion in Proposition 98 funding; \$41.6 billion of

this is for K-12 Education, a \$3.3 billion (8.5%) increase over last year. The K-12 Prop 98 allocation includes a \$143 million Proposition 98 “set aside.” According to the budget, these funds are meant to cover any increased costs in existing programs, such as enrollment growth, that may occur during the year.

Display 3 shows K-12 funding in the 2002-03 budget, along with a breakdown of Proposition 98 funding by recipient agency and by fund source.

*DISPLAY 3 K-12 and Proposition 98 Funding in the 2002-03 Budget
(Dollars in Thousands)*

K-12 Education ¹	2001-02	2002-03	1-year Change	
			<i>Percent</i>	<i>Dollars</i>
General Fund	\$29,589,400	\$30,769,302	4.0%	\$1,179,902
Local Property Taxes	12,022,700	13,037,441	8.4%	1,014,741
Lottery	812,800	812,800	0.0%	0
Other State Funds	126,800	102,200	-19.4%	-24,600
State School Fund	(8,500)	(8,500)	0.0%	0
Federal Funds	5,599,300	6,462,200	15.4%	862,900
Local Debt Service	827,800	827,800	0.0%	0
Local Miscellaneous	3,715,800	3,715,800	0.0%	0
Total Funds	\$52,694,600	\$55,727,543	5.8%	\$3,032,943

Proposition 98 (Gen. Funds)	2002-03	Prop 98, by Source	
K-12 Education	\$28,646,961	Gen Funds	\$31,560,156
California Community Colleges	2,824,741	Prop Tx	14,919,491
Other Prop 98 Agencies	88,454	Total	\$46,479,647
Total, General Funds	\$31,560,156		

1. K-12 includes: SDE, STRS, G.O. debt service, PMIA interest, facilities aid program, debt service on Public School Building Bonds, CTC, and other entities.

Source: California Department of Finance (as of the 2002 Budget Act).

Display 4 on the next page presents a summary of higher education funding in the 2002-03 budget in comparison with the latest estimates for the prior year.

DISPLAY 4 2002-03 Higher Education Budget Summary
(Dollars in Millions)

<u>Calif. Comm. Coll. ¹</u>	<u>2001-02</u>	<u>2002-03</u>	<i>Percent Change</i>	<i>%'ge of Total</i>
General Fund	\$2,854	\$3,005	5.3%	45.2%
Local property taxes	1,849	2,014	8.9%	30.3%
Lottery	164	169	3.0%	2.5%
Student Fees	138	138	0.0%	2.1%
Other Funds ²	<u>1,293</u>	<u>1,319</u>	<u>2.0%</u>	19.8%
Subtotals, CCC	\$6,299	\$6,645	5.5%	
<u>California State Univ.</u>				
General Fund	\$2,707	\$2,680	-1.0%	78.6%
Student Fees	509	547	7.4%	16.0%
Other Funds ²	146	146	-0.1%	4.3%
Lottery	<u>60</u>	<u>38</u>	<u>-37.3%</u>	1.1%
Subtotals, CSU	\$3,423	\$3,412	-0.3%	
<u>Univ. of California</u>				
General Fund	\$3,332	\$3,225	-3.2%	74.5%
Student Fees	663	689	3.9%	15.9%
Offsetting Income ³	428	416	-2.9%	9.6%
Subtotals, UC	\$4,423	\$4,330	-2.1%	
<u>CSAC, Other Higher Ed. ⁴</u>				
CSAC (Gen. Funds)	\$561	\$662	17.8%	77.5%
Other: Gen. Funds	192	176	-8.2%	20.6%
Student Fees	14	14	0.7%	1.6%
Income	2	2	7.7%	0.2%
Lottery	<u>0.154</u>	<u>0.154</u>	<u>0.0%</u>	0.0%
Subtotals, Other	\$769	\$853	11.0%	

1. CCC totals include: G.O. bond debt service, mandates, and STRS.
2. Other Funds include reimbursements, selected fees, and local sources.
3. UC Offsetting Income includes selected fees and reimbursements.
4. Other H. E. includes: G. O. bond interest, redemptions and interest on UC and CSU "pooled money acct." loans, Hastings College, and CPEC.

Source: California Department of Finance.

Other state programs

As shown in Display 2, spending in nearly all non-education categories in the 2002-03 budget declines substantially from last year. Excluding the category “General Government/Tax Relief,” non-education General Fund spending in the budget declines by \$2.2 billion from a year ago, a drop of 7 percent. The category “General Government/Tax Relief” will see a \$1.4 billion General Fund increase from last year’s \$3.4 billion. However, of the nearly \$4.9 billion spent in this category, \$4.4 billion is specifically for tax relief. Interestingly, the State’s reserve fund for economic uncertainties is expected to end the 2002-03 fiscal year with \$1 billion reserve, in contrast to its \$1.4 billion deficit position at the end of 2001-02.

Next steps

As both the Governor and the Legislature have acknowledged, the just-approved budget is only one step in dealing with the severe downturn in revenues experienced by the State. Department of Finance data for the first months of the 2002-03 fiscal year show that monthly revenues are running tens of millions of dollars below levels forecast for the Governor’s May Revise. Some researchers estimate that the current budget deficit is actually \$3 billion higher than the \$23.6 billion addressed in the budget and that next years budget shortfall may approach \$10 billion. To address this shortfall, State policy makers have set in place several mechanisms to further reduce State spending; these are summarized below:

- ♦ The 2002-03 budget authorizes the Governor to make up to \$750 million in additional budget cuts and requires State agencies to prepare plans to reduce just-budgeted expenditure levels by an additional 5%.
- ♦ The 2002-03 budget also eliminates 7,000 State-funded positions through the end of the fiscal year; these are in addition to the thousands of jobs already cut in earlier legislative and executive actions to recapture unfilled positions.
- ♦ The 2002-03 budget calls for providing State employees with specific incentives for early retirement in order to facilitate the reduction in the overall State workforce.
- ♦ The Department of Finance has asked all State agencies to prepare for a 20% reduction in funding in the upcoming 2003-04 budget by submitting plans to eliminate certain functions and to detail how they would operate at this reduced funding level.

All of these actions are designed as the first steps towards lowering State spending in preparation for the depressed revenue climate anticipated for at least the next 22 months.

Possible impact on higher education

As a mostly non-protected category, postsecondary education spending can be particularly vulnerable during times of budget shortfall. California higher education was generally spared from the first few rounds of budget cuts this year, at least as compared with many public health and human

services programs. If additional budget cuts are required later this year, it will be difficult to continue protecting both K-12 and higher education. Most K-12 cuts would have to involve changing the Proposition 98 guarantee in some way, a politically sensitive prospect. In addition, most K-12 expenditures are directly tied to enrollments, making mid-year reductions difficult to enact.

Higher education is one of the few State-funded public services that has access to other revenue sources, including its clients, that can be used to backfill for reductions in General Funds, if policymakers so choose. Also, with the exception of the Proposition 98 portion of the Community Colleges' budget, higher education as a State service is not protected in law and can be vulnerable to funding changes with short notice. All these factors combine to put higher education in the precarious position of being susceptible to both reductions in service (budget cuts) and increases in client costs (student fee hikes) should the current budgetary climate worsen.

What can be done?

California's postsecondary education enterprise can use this current budgetary dilemma to carefully evaluate its collective operations and specific practices in order to achieve greater efficiencies and maintain opportunity. This is common practice during resource shortages. More importantly, the public systems can review their current behaviors from the perspectives of their clientele -- the students -- and undertake adjustments that will position them to continue to serve their students well, should they be called upon to reduce operating expenses. Current administrative, institutional, and support service structures will need to be re-thought in order to provide the greatest numbers of students the kind of education they and the State deserve.

Staff is currently in the process of carefully examining options and developing suggestions for how best to protect the delivery of educational services to students in the event that funding must be reduced or student fees increased. These reviews will enable the Commission to perform its statutory responsibility of advising policymakers on how their decisions may affect students' ability to pursue the education that is critical for their success and for the social and economic well being of our State.
